CALIFORNIA BOARD OF LEGAL SPECIALIZATION
OF THE STATE BAR OF CALIFORNIA

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TAXATION LAW CERTIFICATION EXAM

Date	Sunday, August 14, 2005 9:00 a.m. – 4:00 p.m.
Registration deadline	Friday, July 1, 2005
Exam sites	Westin at San Francisco Airport Radisson at Los Angeles Airport
Fee	$300 writing ($350 if using a laptop PC) *fee includes a box lunch*
Exam format	The exam is divided into two three-hour sessions – the morning session includes 50 multiple-choice questions and two essay questions; the afternoon session includes four essay questions. There are no optional questions; each examinee is expected to answer all questions on the exam. The 50 multiple-choice questions, worth three points each, are designed to be answered in approximately 90 minutes. Each essay question is worth 75 points and is designed to be answered in approximately 45 minutes.
Scoring	The maximum number of points available is 600. A passing score is 420 points, or 70%. Exams with scores between 65-70% are re-read by a Committee of Reappraisers. The decision of the Committee is final, pursuant to section 8.3 of the Rules Governing the State Bar of California Program for Certifying Legal Specialists. Results are mailed only after all reappraisals have been completed.
Reference materials	Examinees may use the following reference materials during the exam: *Internal Revenue Code and Treasury Regulations*. Publications must be unannotated and free of any stray marks. Handwritten notations (other than underlining or highlighting) will not be allowed. The use of Post-It type tabs to mark specific book sections is acceptable, but the tabs must not have writing on them.
Testing accommodations	Available at both sites. Contact ivonne.broussard@calbar.ca.gov or (415) 538-2145 for more information.
Study resources	See attached standards for certification, exam specifications, and sample exam questions.

For more information, visit www.californiaspecialist.org

The Standards must be read in conjunction with the Rules Governing the State Bar of California Program for Certifying Legal Specialists, which govern the Program requirements.

THE STANDARDS FOR CERTIFICATION AND RECERTIFICATION IN TAXATION LAW

1.0 DEFINITION

The practice of taxation law encompasses practice within the field of law involving the Internal Revenue Code and other federal, state and local tax statutes and interpretive material in connection with matters in which issues of taxation are significant.

2.0 TASK REQUIREMENT FOR CERTIFICATION

2.1 An applicant must demonstrate that within the five (5) years immediately preceding the initial application, he or she has been substantially involved in the practice of taxation law, which shall include handling matters in one or more of the following areas:

2.1.1 Individual Income Tax;

2.1.2 Corporate Income Tax;

2.1.3 Partnership Income Tax;

2.1.4 Real Estate Income Tax;

2.1.5 Tax Procedures;

2.1.6 Compensation and Benefit Tax;

2.1.7 California Taxes;

2.1.8 Estate and Gift Tax and Estate Planning;

2.1.9 Tax Exempt Organizations; and

2.1.10 International Tax.

2.2 A prima facie showing of substantial involvement in the area of taxation law is made by performance of the following activities:

2.2.1 Principal author of not less than ten (10) written tax opinions, memoranda, advice letters to clients or similar documents concerning substantive tax issues;

2.2.2 Active participation in not less than five (5) administrative tax examinations, ruling requests, determination letters or similar matters; and

2.2.3 Active participation in not less than five (5) tax litigation proceedings at any level, including appearances before the Appeals division of the IRS or state or local tax agency or revenue authority.

3.0 EDUCATIONAL REQUIREMENT FOR CERTIFICATION

An applicant must show that, within the three (3) years immediately preceding the application for certification, he or she has completed not less than forty-five (45) hours of educational activities specifically approved for taxation law. Such education shall be in at least four (4) of the areas of taxation law specified below, with no fewer than four (4) hours in any of the four (4) areas, nor more than twenty (20) hours in any one area, or by receiving, within the five (5) years immediately preceding application, an LL.M. degree in taxation law from a law school accredited by the American Bar Association or a degree determined to be equivalent by the Advisory Commission:

3.1 Individual Income Tax - Federal and California tax law relating to individual business tax matters including forms of business entities, real estate and other investments; and federal and California tax law relating to individual personal taxes, including family matters and foreign tax matters;

3.2 Corporate Income Tax - Federal and California tax law relating to the formation, operation, reorganization and liquidation of corporations, and the tax status of particular kinds of corporate entities;

3.3 Partnership Income Tax - Federal and California tax law relating to the formation, operation, reorganization and liquidation of partnerships and the tax status of particular kinds of partnership entities;

3.4 Real Estate Income Tax - Federal and California tax law relating to the acquisition, development, operation and disposition of real estate;

3.5 Tax Procedures - Federal and California income, estate and gift tax law relating to the preparation of returns, elections, audits, appeals, and litigation in civil and criminal matters;

3.6 Compensation and Benefits Tax - Federal and California income, estate and gift tax law relating to employee compensation, including stock options and other payments in kind; employee benefit plans, including ERISA and other qualified and nonqualified retirement and fringe benefit matters;

3.7 California Taxes - California personal and corporate income, property, sales and use and other local taxes;

3.8 Estate, Gift Tax and Estate Planning - Federal and California tax law relating to disposition of property including estate planning;

3.9 Tax Exempt Organizations - Federal and California tax law relating to tax exempt organizations;

3.10 Current Developments - Federal and California income, estate and gift tax law relating to current developments in any of the other areas of the tax law curriculum, of the kind covered by annual tax seminars, institutes and similar programs;

3.11 International Tax - Federal and California tax law relating to the taxation of non-resident aliens, foreign entities and foreign related transactions; and

3.12 Ethics of Tax Practice - Courses covering the ethical considerations of tax practice, including tax opinions, Circular 230, conflicts of interest, penalties and related matters.

4.0 TASK REQUIREMENT FOR RECERTIFICATION

An applicant for recertification must show that during the current five (5) year certification period he or she has been substantially involved in the practice of taxation law. Such showing shall be made by compliance with the requirements set forth in section 2.0 or, at the discretion of the Commission, by sworn statement that the applicant has been involved in the practice of taxation law substantially to the same extent as described in the application for original certification.

5.0 EDUCATIONAL REQUIREMENT FOR RECERTIFICATION

An applicant for recertification must show that, during the current five (5) year certification period, he or she has completed not less than sixty (60) hours of educational activities specifically approved for taxation law specialists, or by receiving, within the five (5) years immediately preceding application, an LL.M. degree in taxation law from a law school accredited by the American Bar Association or a degree determined to be equivalent by the Advisory Commission.

Specifications For State Bar of California
Taxation Law Certification Examination

Purpose of the Examination: The Taxation Law Examination consists of a combination of essay and multiple-choice questions. It is designed to verify the applicant's knowledge of and proficiency in the usual legal procedures and substantive law that should be common to specialists in the field as represented by the skills listed below. We recognize that these skills are interrelated, which may require that you apply several skills in responding to a single exam question. Also, the order of the skills does not reflect their relative importance, nor does the skill sequence represent an implied order of their application in practice.

Your answers to the exam questions should reflect your ability to identify and resolve issues, apply the law to the facts given, and show knowledge and understanding of the pertinent principles and theories of law, their relationship to each other, and their qualifications and limitations. Of primary importance for the essay questions will be the quality of your analysis and explanation.

Knowledge of the following fundamental lawyering skills may be assessed:

Skill 1: Professional Responsibility

- 1.1 Duties to clients, opposing counsel and the Court
- 1.2 Bases for attorney's fees
- 1.3 Bases for sanctions
- 1.4 Fee agreements
- 1.5 Arbitration/mediation and dual representation
- 1.6 Conduct resulting in malpractice/discipline

Skill 2: Taxation Litigation and Procedures (Trial and Appellate)

- 2.1 Evidence
- 2.2 Jurisdiction/venue
- 2.3 Expert witnesses
- 2.4 Discovery and investigation
- 2.5 Preservation of record and appeals
- 2.6 Choice of forum

Skill 3: Individual Income Taxation

- 3.1 Compensation, benefits and other income
- 3.2 Exempt income and personal deductions
- 3.3 Qualified Retirement Plan distributions
- 3.4 Basis gains and losses
- 3.5 Charitable giving including use of trusts

Skill 4: Corporate Income Taxation

- 4.1 Formation
- 4.2 Operation
- 4.3 Distributions
- 4.4 Reorganization/liquidation

Skill 5: Partnership and Pass-Through Entity Income

- 5.1 Formation
- 5.2 Operation
- 5.3 Reorganization/liquidation
- 5.4 Check-the-box regulations

Skill 6: Real Estate Taxation

6.1 Acquisition
6.2 Development
6.3 Operation/disposition
6.4 State and local property taxes

Skill 7: Estate and Gift Tax

7.1 Estate and Gift Tax Planning
7.2 Generation skipping planning
7.3 Marital deduction planning
7.4 Valuation issues
7.5 Includable/excludable items
7.6 Post-mortem planning

Skill 8: Fiduciary Income Tax

8.1 Grantor trusts
8.2 Distributions from estates and trusts

Skill 9: Tax Exempt Organizations

9.1 Formation
9.2 Operations
9.3 Private foundations
9.4 Unrelated business income
9.5 Prohibited transactions

Skill 10: International Tax

10.1 Foreign activities of US persons (outbound transactions)
10.2 US Activities of foreign persons (inbound transactions)
10.3 Cross-border estates and trusts transactions (international estate planning)
10.4 Transfer pricing
10.5 Cross-border formations, liquidations, reorganizations and acquisitions

STATE BAR OF CALIFORNIA TAXATION LAW CERTIFICATION EXAM

SAMPLE QUESTIONS

Sample Question #1

Frank is an 87-year old widower in very poor health, but there is good reason to believe that he may live at least another three (3) years, if all goes well. He has no family other than his very healthy unmarried daughter Cindy, his sole heir. Both Frank and Cindy are U.S. citizens residing in California. Frank shows you the following list of his assets:

Frank's Financial Information Table

	Column A Fair Market Value	Column B Adjusted Basis	Column C Unrealized Gain (Col A less Col B)	Column D Property Tax Assessed Value
Cash and Personal Property	$225,000	$200,000	$25,000	N/A
Frank's House	$500,000	$100,000	$400,000	$80,000
Triplex Apartment Rental	$275,000	$50,000	$225,000	$50,000
TOTALS	**$1,000,000**	**$350,000**	**$650,000**	**$130,000**

Frank tells you that: (a) all of his properties are located in California, (b) he has no mortgages or other debt, and (c) he has made no prior taxable gifts. Frank would like to transfer his house to Cindy, but he has not yet done so and seeks your advice. Frank tells you, and you are to assume, that property values are going to remain stable and not change at least well past Frank's death, and that Cindy has agreed that Frank can continue to live alone in the house as his principal residence without paying rent until his death (unless you advise otherwise), and Cindy will pay the real property taxes and other expenses of owning the house. Following the end of Frank's occupancy of the house, Cindy intends to occupy the house as her principal residence.

A. Discuss the estate and gift tax aspects of Frank's transferring the house to Cindy as a gift versus leaving it to her as a bequest.

B. Discuss the positive and negative income tax aspects of Frank's transferring the house to Cindy as a gift versus leaving it to her as a bequest.

C. If Frank should die before he transfers any real estate, discuss what the California real property tax consequences to Cindy will be when she inherits the house and triplex.

Sample Question #2

In December 1999, Francisco, a real estate developer, was introduced to Sally who owns a large farm (10,000 acres). Francisco and Sally are and have been U.S. citizens and California residents for their entire respective lives. Sally inherited the farm from her mother in 1975. Upon the audit of her mother's estate, the estate tax value of the farm was confirmed by the IRS to be $200,000.

At the close of 1999, the fair market value of the farm property in its highest and best use (as developed real estate) was appraised at $2,000,000. All acres of the farm are of equal value and remain so. The farm property was subject to a mortgage of $200,000 with recourse by the lender only against the property.

In December of 1999, Francisco suggested that he and Sally form a limited partnership. Since Sally did not wish to participate in the day-to-day management of the partnership, Francisco suggested that he be the sole general partner and Sally be the sole limited partner.

On January 2, 2000, the two individuals formed a California limited partnership known as Creekside Estates, Ltd. ("Creekside"). Immediately thereafter, Sally as the sole limited partner contributed her farm (all 10,000 acres) to Creekside subject to the $200,000 mortgage. Francisco contributed no capital to the partnership.

Under the limited partnership agreement, Francisco as the sole general partner receives only a subordinated net profits interest of 50 percent determined after Sally has been allocated priority net profits equal to 10 percent simple annual return on her contributed capital amounts based on fair market value of the farm on date of contribution to the partnership. The other 50 percent of residual net profits (after reduction for the priority profits share of Sally) is allocated to Sally. The computation period for the priority profits share begins January 1, 2000 and ends on December 31 of the year the entire project is sold.

On February 1, 2000, Creekside obtained a loan of $3,000,000 from a local bank recourse only against the assets of the partnership. On the same day, using a portion of the bank loan proceeds Creekside paid off the $200,000 mortgage against the farm. Immediately thereafter, the remainder of the bank loan was drawn down and U.S. Treasury bonds are purchased at face with the drawn loan proceeds of $2,800,000.

By the end of 2001, the entire 10,000 acres were subdivided and developed by Creekside. The cost of development including any expenses required to be capitalized was entirely funded from the net proceeds from the sale of the Treasury Bonds at face. All of the costs of development were capitalized. The interest income derived from the Treasury bonds not required to be capitalized was exactly offset by currently deductible general administration expenses.

In 2002, Creekside sold all the developed real estate in separate sales. Creekside made no sales in any year except 2002. The combined gross receipts from all of the sales of the 10,000 acres net of closing costs were $8,000,000. All currently deductible general administration expenses for 2002 including interest expense were exactly offset by miscellaneous income derived by the partnership in 2002. The loan balance owed to the bank remains at $3,000,000.

A. Determine and discuss the Federal income tax consequences to Francisco upon the receipt of a net profits interest in the limited partnership in 2000.

B. Determine and discuss the Federal adjusted tax basis of Sally with respect to her limited partnership interest immediately after the contribution of the farm to the limited partnership before the borrowing by the limited partnership from the bank.

C. Determine and discuss the effect of the borrowing by the limited partnership from the bank on the Federal adjusted tax basis of each partner in his or her partnership interest immediately after the borrowing.

D. Determine and discuss the Federal income tax consequences to each of the partners of the sales by Creekside of the 10,000 acres in 2002.

Sample Question #3

John and Jane Jones (husband and wife) own an undivided 75% interest in the 250-space Sunny Mobile Home Park (the "Park"), and Sam and Sue Smith (husband and wife) own a 25% interest in the Park. Both families are California residents. The Park is located in California. The pertinent financial data relating to the park is as follows:

Tax Basis of Land		$1,500,000
Cost of Improvements	$2,000,000	
Depreciation on Improvements	(1,200,000)	
Basis of Improvements		800,000

Basis of Land and Improvements		$2,300,000
Non-Recourse Note Secured by First Trust Deed on Mobile Home Park		$5,000,000

Annual Income and Expenses:

Income from Rentals		$1,000,000
Operating Expenses	($ 300,000)	
Interest	(350,000)	
Depreciation	(60,000)	
Total Expenses		($ 710,000)
Taxable Income		$ 290,000

Annual Cash Flow:

Income from Rentals		$1,000,000
Operating Expenses	($ 300,000)	
Capital Expenditures	(50,000)	
Principal and Interest on Loan	(390,000)	
Total Disbursements		($ 740,000)
Cash Distributed to Owners		$ 260,000

The Joneses and Smiths have each reported their share of the income and expense on their individual income tax returns, and have never filed a partnership tax return with respect to this property. The four owners are between 60 and 80 years old, have several children and grandchildren, and would like to dispose of the entire property in approximately 10 years. Their objectives include a desire to transfer assets to their children and grandchildren with a minimal tax (income, property, estate and gift) burden, while retaining at least 80% of their current cash flow from the property.

They believe that the cash available for distribution will increase at the rate of 5% per year and the current value of $10 million will also increase at the rate of 5% per year. The current loan may be prepaid without penalty, does not have a Due on Transfer provision, and in non-recourse. The Joneses and Smiths seek your advice and want to know the reasons for your recommendations.

A. What recommendations should be made to help the parties further their objectives? Discuss.

B. If the Mobile Home Park was owned by a C Corporation in which the Joneses owned 75% of the stock and the Smiths owned 25% of the stock, what recommendations should be made to help the parties further their objectives? Discuss.

<u>Sample Question #4</u>

Mr. Slater's commercial warehouse was completely destroyed by a fire on July 15, 2001. The warehouse was tenantless and not in use, but Mr. Slater happened to be inside the warehouse doing an inspection at the time of the fire. Mr. Slater was able to escape, but broke a leg, suffered smoke inhalation, and burned both hands as he made his escape before the building collapsed. Mr. Slater was only partially recovered from his injuries on July 15, 2003, when he received a settlement of $3,000,000 from his insurance company. Additional information about Mr. Slater's commercial warehouse and settlement is set forth below:

Fair market value of warehouse (immediately prior to fire)	$2,000,000
Allocation of settlement proceeds to warehouse	$2,000,000
Allocation of settlement proceeds to personal injuries	$1,000,000
Cost of warehouse	$1,250,000
Accumulated depreciation warehouse (immediately prior to fire)	$ 400,000

Mr. Slater used $1,000,000 of the settlement proceeds to construct a new commercial warehouse, $1,000,000 to acquire publicly-traded stock, paid his outstanding medical bills, which were substantial, and is holding the balance of the settlement proceeds in cash as a reserve for future medical expenses.

A. Mr. Slater comes to you during December of 2003 to discuss the taxation of his settlement. Discuss how the settlement proceeds of $2,000,000, which are properly attributable to the loss of the warehouse, should be treated for federal income tax purposes.

B. Mr. Slater is also interested in discussing the taxation of the $1,000,000 settlement proceeds attributable to his personal injuries. Assume that Mr. Slater's medical bills were $500,000 and that he is likely to require additional medical attention in the future due to the nature of his injuries. Discuss the taxation of this component of Mr. Slater's settlement.

C. The IRS audits Mr. Slater's 2003 U. S. Individual Income Tax Return, rejects the positions taken with respect to both the warehouse and personal injury settlement, and issues a statutory notice of deficiency. Mr. Slater visits you again to ask what his procedural options are. What do you tell him and what is your recommendation?

<u>Sample Question #5</u>

Richard and Susan Harris, husband and wife, own 100% of Harris Construction Company, a California corporation engaged in the development of commercial property. Harris Construction Company has a 401(k) plan. Richard is a full time employee of Harris Construction Company and has approximately $300,000 in his 401(k) plan as of December 31, 2003. Susan does not work and has never worked at Harris Construction Company.

Richard Harris has a 50% community property interest in the shares of Harris Construction Company and will reach age 70½ during 2003. He has no plans to retire, but would like to meet with you to discuss retirement planning.

Harris Construction Company generally employs a minimum of fifty-five (55) workers. Ten (10) of the workers, including Richard Harris, have been properly characterized as employees of Harris Construction Company for employment tax purposes at all times. The remaining forty-five (45) workers are construction workers. The IRS has recently examined the 2001 Form 1120 U.S. Corporation Income Tax Return of Harris Construction Company and determined that all of the construction workers, who have been characterized as independent contractors for federal employment tax purposes, should have been characterized as employees. Harris Construction Company was established in 1970 and has consistently characterized all of its construction workers as independent contractors since the inception of the business.

Richard Harris has also asked to meet with you to discuss the Harris Construction Company employment tax case. He has received a Notice of Proposed Adjustments from the IRS examining agent and would like to discuss strategy.

Irrespective of the employment tax controversy, Susan Harris would like to establish a private foundation during 2003. The private foundation would provide support to qualified charitable organizations throughout the community where the Harris family has lived for many years. Richard and Susan Harris will have adjusted gross income of $2,000,000 at December 31, 2003.

Richard and Susan Harris intend to contribute cash of $500,000 or stock of Harris Construction Company with a value of $500,000 to the newly established private foundation. Richard and Susan Harris have a basis of $2,500 in the shares of stock that would be contributed to the foundation.

A. What advice should you provide to Richard Harris about his 401(k) plan?

B. Discuss your approach to the Harris Construction Company employment tax case.

C. Which asset should be contributed to the private foundation? Discuss.

Sample Question #6

Joe and Betty (husband and wife) purchased all of the stock in Minimarket, Inc., a C Corporation, as tenants in common for $100,000, on January 1, 2000. At the time of the purchase, the corporation had the following balance sheet:

Assets		
Cash		$ 10,000
Equipment:		
Cost	$110,000	
Depreciation	(20,000)	
Total Equipment		$ 90,000
Total Assets		$100,000
Liabilities		$ 0
Capital		
Capital Stock	$ 1,000	
Retained earnings	$ 99,000	
Extra Value re: Appreciation		
		$100,000

On May 1, 2003, Joe and Betty agreed to dissolve their marriage. The only mention of the Minimarket, Inc. stock in the property settlement agreement read as follows: “Betty shall receive $50,000 in exchange for her Minimarket, Inc. stock.” On July 1, 2003, Minimarket, Inc. issued its check to Betty for $50,000 and Betty gave Joe her stock certificate and a stock power signed in blank. In January 2004, Joe sold all of his Minimarket stock for $50,000 to an unrelated third party. Between January 1, 2000 and January 2004, Minimarket operated at a break-even and did not pay any dividends.

A. What is the amount and nature of Betty’s taxable income as a result of the foregoing transactions? Discuss.

B. What is the amount and nature of Joe’s taxable income as a result of the foregoing transactions? Discuss.

C. What, if anything, could the parties have done to change the tax consequences without changing the non-tax economic result? Discuss.